

**SECTION 209**

**ECONOMIC ADJUSTMENT PROGRAM**

**REVOLVING LOAN FUND GRANTS**

**AUDIT GUIDELINES**



**DECEMBER, 1998**

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## **SECTION 209 ECONOMIC ADJUSTMENT PROGRAM REVOLVING LOAN FUND GRANTS AUDIT GUIDELINES**

### **I. PURPOSE**

This document describes the audit requirements for revolving loan fund (RLF) grants funded under the Section 209 Economic Adjustment Program of the Economic Development Administration (EDA). It provides an overview of relevant Office of Management and Budget (OMB) circulars and other Federal regulations as they relate to administrative and audit requirements for EDA RLF grants. It also discusses costs that may be eligible under an RLF grant program and requirements for records retention. It is intended to supplement applicable OMB circulars and Federal regulations. If there is a conflict between information contained in this document and the OMB circulars or Federal regulations, the latter shall prevail. In the absence of a conflict, EDA reserves the right to limit Federal standards.

This document is intended for grant recipients and for independent auditors as an aid in understanding the audit and compliance requirements for EDA RLF grants. Each recipient of an EDA RLF grant is responsible for reading this document and providing it to the independent auditor *prior* to the start of an audit. Failure to make this information available to the independent auditor could result in an unacceptable audit report.

### **II. PROGRAM OBJECTIVES**

RLF grants are administered under EDA's Section 209 Program, which was created in 1974 by an amendment to the Public Works and Economic Development Act of 1965 (PWEDA), to provide grant assistance to help communities adjust to sudden and severe economic dislocations (SSED) and long-term economic deterioration (LTED). EDA Section 209 grants may be used for business development assistance, planning, research, technical assistance, training, infrastructure, and other development activities which meet the purpose of the program.

RLF grants provide capital for loan pools which finance business development activities consistent with local economic development strategies. Loan repayments, plus interest and other related income, create a revolving source of capital to finance other business enterprises. RLF loans are used to stimulate economic activity and to provide financing to businesses when private credit is unavailable to complete a project.

### **III. PROGRAM PROCEDURES**

Priority consideration for RLF funding is given to those proposals which have the greatest potential to benefit areas experiencing or threatened with substantial economic distress. Proposals are evaluated based on conformance with statutory and regulatory requirements, the economic adjustment needs of the area, the merits of the proposed project in addressing those needs, and the applicant's ability to manage the grant effectively. Each approved RLF grant is operated in accordance with an RLF Plan which is part of the grant agreement. The RLF Plan summarizes the RLF's strategic objectives and the operational procedures to carry out the purpose of the grant.

### **IV. PROGRAM HISTORY**

EDA awarded its first RLF grant in 1975. To date, the Agency has awarded more than 700 grants aggregating in excess of \$500 million for the establishment or recapitalization of RLFs nationwide. In turn, RLF grantees have made more than 7,200 loans to private sector businesses, which loans have either leveraged or have the potential for leveraging in excess of \$1.9 billion private capital based on a private investment to total RLF monies loaned ratio of 3.83:1. There are generally two types of RLF grants, those established as RLFs from the initial disbursement of grant funds, and those established only after repayments are received from business loans originally funded from grants. Most RLF grants are of the first type.

RLF programs are operated by local governments, regional development corporations, States and other non-profit organizations. EDA RLF grants normally require a matching contribution from local sources. Historically, the local match contribution has averaged 25% of an RLF's capitalization, but waivers have been extended in special situations such as natural disasters. The average EDA RLF grant was capitalized at just over \$1 million in total assets. While the size of individual loans extended by these grant recipients vary markedly, the typical RLF loan has averaged \$70,000 over time.

### **V. FREQUENCY OF AUDITS**

Each RLF grant recipient shall have an audit performed annually for the duration of the RLF program except in the following *limited* circumstances which may permit biennial audits:

- A state or local government recipient that adopted a mandatory, constitutional or statutory *requirement* for less frequent audits prior to January 1, 1987, which requirement still remains in effect; or
- A non-profit recipient that had biennial audits for all biennial periods ending between July 1, 1992 and January 1, 1995.

## VI. WHEN AN AUDIT IS REQUIRED

Pursuant to the Single Audit Act Amendments of 1996 (P.L 104-156) and OMB Circular A-133, audits are required of all State, local government and non-profit corporation RLF grant recipients that expended total Federal awards of **at least \$300,000** in a given fiscal year. For all RLF grants, the calculation of RLF expenditures will include the beginning balance of all outstanding loans plus the current year's loan and loan-related expenditures. With the exception of newly awarded grants and limited circumstances listed in Paragraph V. herein, the majority of RLF grant recipients will require an annual audit.

To calculate the total RLF expended, follow the information provided in the box below. Note that only the Federal share (exclude the matching fund share) of the amount calculated should be used for the determination of an audit. Audit procedures, however, must encompass both the Federal and any matching funds which comprise an RLF.

- The year's beginning balance of outstanding RLF loans; plus
- RLF loan expenditures during the fiscal year; plus
- The amount of RLF Income<sup>1</sup> earned and expended on eligible administrative expenses during the fiscal year.

## VII. TYPES OF AUDITS

Entities which spend \$300,000 or more in Federal awards will be required to have either (i) a **program-specific audit** or (ii) a **single audit**. An entity can elect a program-specific audit if all funds expended come from only one Federal program. An entity must have a single audit in a fiscal year in which it spends funds from more than one Federal program.

These guidelines are not intended to be a complete manual of procedures, nor are they intended to supplant the auditor's judgment of the work required for either the program-specific audit or a single audit which includes coverage of an EDA RLF. The auditor should refer to OMB Circular A-133 for a detailed listing of requirements for these types of audits. These guidelines are designed to discuss special considerations for audits of RLFs.

### A. PROGRAM SPECIFIC AUDIT

A program-specific audit is an audit of one program performed in accordance with Federal laws and regulations and any audit guides available for that program. There is not a program-specific audit guide written for the RLF program. Since a program-specific audit guide is not available, the auditee

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<sup>1</sup> RLF Income includes interest earned on loans, interest earned on accounts holding RLF funds not needed for immediate lending, loan fees received from borrowers, and other income generated from RLF activities.

and auditor shall have basically the same responsibilities for the RLF program as they would have for an audit of a major program in a single audit. Section VIII of these guidelines describes some special considerations for auditing an EDA RLF. OMB Circular A-133, Section 235 provides instructions for completing a program-specific audit.

## B. SINGLE AUDIT

A single audit covers all Federal awards received and expended during an organization's fiscal year. Unlike the program specific audit, this type of audit requires a financial statement audit of the grant recipient. A single audit is performed by an independent auditor who meets the general standards specified in generally accepted government auditing standards.

Attachment I provides a current list of applicable audit-related documents with which the auditor should become familiar. Since accounting requirements and reference materials are subject to periodic revisions, grant recipients and auditors are responsible for utilizing the most current reference information available.

## VIII. SPECIAL CONSIDERATIONS FOR SINGLE AUDITS OF RLFs

### A. SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

The auditee is required to report certain information in this schedule including: (1) the identity of all Federal award programs by program title and by catalogue number listed in the *Catalog of Federal Domestic Assistance (CFDA)* and (2) the total expenditures for each Federal award program by grantor agency. For EDA RLF grants, the program title is "*Special Economic Development and Assistance Programs - [either Sudden and Severe Economic Dislocation (SSED) or Long-Term Economic Deterioration (LTED)] Revolving Loan Fund.*" The CFDA number is "11.307" for both SSED and LTED grants. To assist program officials, it is helpful to include the number of each EDA RLF grant in the schedule. The method for calculating the total Federal expenditure amount to be reported on the schedule is shown in Section VIII.C. below.

Note that in the third and fourth digits of each grant number, an SSED grant is denoted by the number "19", and an LTED grant by the number "39". Exceptions include numerical identification of defense or disaster-related RLFs which may have several variations as determined by fiscal year or specific disaster program appropriations.

### B. CRITERIA FOR DETERMINING MAJOR PROGRAMS

Federal award programs must be identified as Major Programs through a risk-based approach described in OMB Circular A-133. Prior to the issuance of the revised OMB Circular A-133, a Major Program was defined solely in monetary terms. The new risk-based approach also requires that the auditor consider the current and prior audit results and the inherent risk of the program in making a determination of Major Programs subject to audit. Major Programs require more extensive audit procedures than Other Federal Programs.

### C. CALCULATING "TOTAL FEDERAL EXPENDITURES" FOR RLF GRANTS

For RLF grants, "Total Federal expenditures" normally includes only the Federal share of an RLF's expenditures. It is calculated as shown in the box below using only the Federal share of each component.

Determining Total Federal Expenditures<sup>2</sup>:

- The year's beginning balance of outstanding RLF loans; plus
- RLF loan expenditures during the fiscal year; plus
- The amount of RLF Income<sup>3</sup> earned and expended on eligible administrative expenses during the fiscal year.

### D. FOOTNOTE DISCLOSURE (SCHEDULE)

In addition to reporting the Federal expenditures for an RLF program on the schedule of expenditures of Federal awards, a footnote to the schedule should disclose the **value of the loans outstanding** at the end of the year.

## IX. USE OF ANOTHER ENTITY FOR PROGRAM ADMINISTRATION

A grant recipient may employ the services of another organization to perform certain duties and responsibilities under a grant. In delegating responsibilities, the grant recipient may be responsible for ensuring that the other entity is audited in accordance with OMB Circular A-133 and complies with the grant terms and conditions. The degree of responsibility delegated is the key factor in determining whether another entity is a subrecipient or vendor (and whether an audit is required). Subrecipients are normally required to have an audit performed while vendors would not usually be audited unless program compliance requirements apply to the vendor.

An organization is a **subrecipient** if it receives or is responsible for RLF funds, and some or all of the following characteristics exist. It is responsible for (i) applicable grant compliance requirements; (ii) programmatic decisions including, but not limited to, approving RLF lending policies, final lending decisions including eligibility determinations, major amendments to loans, and/or

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<sup>2</sup>If the Federal share of an RLF's total expenditures cannot be readily determined, the total RLF expenditures (including both Federal *and* matching funds) may be used in lieu of "total Federal expenditures" provided the inclusion of matching funds is disclosed.

<sup>3</sup>Defined in footnote 1, page 3.

foreclosure actions; and/or (iii) its performance is measured against meeting objectives of the program.

An organization is a **vendor** if it provides services in support of an RLF grant and has the following distinguishing characteristics. It provides agreed services within its normal business operations and provides similar services to other purchasers, it operates in a competitive environment, and program compliance requirements usually do not directly pertain to the services provided. If grant compliance requirements apply to the vendor's activities, the grant recipient is responsible for ensuring compliance by the vendor. This may require monitoring the vendor's activities or requiring an audit of vendor activities as may be appropriate under the circumstances. A vendor is normally responsible only for compliance within the terms of its contract.

An example of a vendor would be a bank or collection company which provides services to the grant recipient merely for the collection of loan payments. This would be considered a vendor relationship because the entity under contract would not be involved with any major program decisions. However, if this entity had expanded responsibilities, such as the final approval authority for loans and foreclosure actions, it would be considered a subrecipient due to the nature and degree of its responsibilities. It would be required to be audited in accordance with OMB Circular A-133, and to comply with the terms and conditions of the grant.

## **X. REPORTING ENTITY**

The definition of a financial reporting entity is based upon the concept of accountability. A reporting entity may consist of a primary unit and component units. The decision to include a component unit in the reporting entity is based on whether (1) the primary unit is financially accountable for the component unit, and (2) the nature and significance of the relationship between the primary unit and the component unit is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

While it is management's responsibility to define the reporting entity, one of the initial tasks performed by the auditor is to independently determine whether management has properly defined the reporting entity, pursuant to the Government Accounting Standards Board's (GASB) Statement No. 14, *The Financial Reporting Entity*.

## **XI. AUDIT REPORT DUE DATES**

The audit must be completed and the report package submitted within 9 months following the end of the period audited, unless a longer period has been agreed to in advance. However, for fiscal years ending on or before June 30, 1998, auditees shall have 13 months after the end of the audit period to submit the reporting package. In either case, the required reporting package shall be submitted within 30 days after issuance of the auditor's report to the auditee.

## **XII. DISTRIBUTION OF THE AUDIT REPORT**

The reporting package should be submitted to the Federal Clearinghouse in accordance with the requirements of OMB Circular A-133, Section 320. In addition, an auditee shall submit the reporting package, leaving out the data collection form which is strictly for the Clearinghouse's use, to the EDA regional office responsible for monitoring the RLF.

## **XIII. AUDITOR SELECTION**

In arranging for audit services, grant recipients are required to follow the administrative requirements and procurement standards prescribed in the applicable Federal administrative document found at 15 CFR, Part 24, or OMB Circular A-110. In addition, guidance in selection of an auditor is available in a document entitled "How to Avoid a Substandard Audit: Suggestions for Procuring an Audit." This document was developed by the National Intergovernmental Audit Forum and is available from the General Accounting Office at telephone number (202) 512-6000.

## **XIV. COMPLIANCE GUIDELINES**

For both program specific audits and single audits, the auditor is required to determine whether the grant recipient has complied with applicable laws and regulations.

Compliance testing involves (1) the testing of *specific* requirements for individual Federal programs, as available, and (2) the testing of *general* requirements which are applicable to all Federal programs. In addition, there may be other laws and regulations listed in the grant terms which may apply to both the grant recipient and to the RLF loan recipients.

OMB has issued a provisional compliance supplement for use with the revised OMB Circular A-133. The provisional compliance supplement addresses 14 types of compliance areas that are generic to all programs. It also addresses specific requirements for about 100 programs. It is not clear whether the RLF program will be included in the compliance supplement.

### **A. SPECIFIC COMPLIANCE REQUIREMENTS**

DOC's **proposed** compliance requirements and suggested audit procedures for EDA Section 209 RLF grants are provided in Attachment 2. Independent auditors should follow these procedures in testing for specific compliance requirements for RLF grants. Comments and suggestions on this material are welcome and should be submitted to the U.S. Department of Commerce, Office of Inspector General, 401 W. Peachtree Street, N.W., Suite 2342, Atlanta, GA 30308.

### **B. GENERAL COMPLIANCE REQUIREMENTS - SUPPLEMENTAL INFORMATION**

The OMB *Compliance Supplements* list fourteen general requirements and suggested auditing procedures which are applicable to all Federal assistance awards. For the general requirement

listed as "Allowable Costs And Cost Principles," supplemental information is provided below. This information should be considered when testing general compliance requirements.

## 1. BACKGROUND

Eligible Costs For RLF Grants: EDA grant funds and matching funds for an RLF must be used in accordance with the purposes specified in the grant agreement. Eligible uses generally include RLF loans and any specified costs listed in the grant agreement (e.g., budgeted audit costs). Unless specifically stated in the grant, the costs to administer an RLF program are not eligible for reimbursement from either the EDA grant or the matching funds.

RLF Income: RLF Income includes interest earned on loans, interest earned on accounts holding RLF funds not needed for immediate lending, loan fees and other income generated from RLF activities. RLF Income may be used only for RLF loans or for eligible expenses necessary to operate an RLF program. RLF Income that is used for RLF administrative expenses is subject to applicable OMB cost principles and to the requirements described below.

Only current period expenses may be expensed against current period RLF Income. Any exceptions to this require EDA approval. The accounting period for determining compliance with this requirement is selected by the grant recipient and may be either the recipient's or the Federal fiscal year. The accounting period selected is submitted to EDA in the annual or semiannual reports. (Refer to Section VII. of the prevailing EDA RLF Administrative Manual for additional details.)

RLF program funds (including initial grant and matching funds and the repayments of loan principle and RLF Income) should be separately accounted for in the accounting system of each grant recipient. When possible, expenses charged to an RLF program should be categorized in detail at least at the level indicated in the RLF Income and Expense Statement (see Exhibit A of EDA's prevailing RLF Administrative Manual).

Cost Principles: The applicable OMB Cost Principles are found in either OMB Circular A-21, A-87, or A-122. Administrative costs that may be charged against RLF Income will be classified as either direct or indirect costs. Direct costs include those that can be identified specifically with a particular cost objective, such as an RLF program. Indirect costs are those incurred for a common or joint purpose benefitting more than one program or cost objective and are not readily assignable.

Cost Allocation Plans: Costs may be allocated against RLF Income only to the extent that they can be distributed in reasonable proportion to the benefits received, and are supported by a cost allocation plan and formal accounting records which will substantiate the propriety of charges. Indirect costs may not exceed 100% of allowable direct costs as reflected in the cost allocation plan.

Cost allocation plans, which include indirect cost rate proposals, normally must be approved by the cognizant Federal agency. Local governments (OMB Circular A-87 organizations) are required to retain cost allocation plans and/or indirect cost rate proposals at the local level unless the cognizant agency requests submittal for negotiation and approval. All cost allocation plans and/or indirect cost rate proposals must be approved at the local level and must be available to the cognizant agency, if requested. The independent auditor is responsible for reviewing cost allocation plans and/or indirect cost rate proposals to determine the reasonableness and validity of costs charged against different cost objectives or programs.

The Office of Inspector General, U.S. Department of Commerce (OIG), is designated the cognizant agency responsible for the audit, approval and negotiation of cost allocation plans and/or indirect cost rate proposals for most EDA economic development districts, as defined in Title IV of PWEDA. When an EDA district organization allocates costs requiring a cost allocation plan and/or an indirect cost rate proposal, the organization is not required to submit either of these to the OIG *unless* the OIG is the cognizant agency and requests submittal, or the cost allocation plan and/or the indirect cost rate proposal is the initial one for the organization. Cost allocation plans and indirect cost rate proposals must be available for review upon demand, if requested.

## 2. COMMON RLF ADMINISTRATIVE COSTS

A description of common administrative costs that may be charged against RLF Income include, but are not limited to, the following:

Advertising/Marketing: Allowable costs for advertising and marketing include costs for media services to recruit RLF personnel, market the RLF program, solicit RLF loan prospects, procure RLF-related goods and services, and sell RLF assets. Eligible costs may also include the cost of printing RLF brochures and travel and other expenses directly related to the promotion of an RLF program.

Audits: The costs of audits conducted in accordance with the grant audit requirements are allowable. The charges may be treated as either direct or indirect costs consistent with the applicable OMB cost principles. Grant and matching funds may be used for audit costs only to the extent listed in the approved grant budget or grant terms. In addition, auditing costs charged against an RLF program may not exceed an RLF's equitable share of the cost.

Bonding: The costs of premiums for fidelity bonds covering employees who handle RLF funds are allowable to the extent that such costs are reasonable and distributed equitably in proportion to the RLF's share of the costs.

Building Space: Rent for building space or the utilization of depreciation or use allowances is an allowable expense subject to the provisions of the applicable OMB cost principles. Maintenance costs are eligible expenses to the extent that they are not otherwise included in rental or other charges for space. See also "Lease Transactions" below.

Capital Expenditures: In accordance with current OMB cost principles, capital expenditures for equipment and other capital assets require prior EDA approval. For state and local governments (OMB Circular A-87), equipment is defined as tangible, personal property having a useful life of more than one year and an acquisition cost which equals the lesser of the capitalization level established by the organization or \$5,000. For nonprofits (OMB Circular A-122 organizations), equipment is defined as tangible, personal property having a useful life of more than two years and an acquisition cost of more than \$500 per unit. The dollar amount for nonprofits is expected to increase when OMB Circular A-122 is revised. In the interim, nonprofits may request EDA to approve an amendment to the grant terms to allow for purchases of capital equipment up to the lesser of the capitalization level established by the organization or \$5,000<sup>4</sup>.

Where appropriate, an analysis should be made of lease vs. purchase alternatives to determine which would be the most economical and practical procurement method. To be an allowable charge against RLF Income, a capital expenditure must be reasonable and essential for the operation and administration of an RLF program. Such charges must reflect an RLF's use of the equipment based upon an equitable allocation method.

Alternatively, grant recipients may be compensated for the use of equipment and other nonexpendable personal property through depreciation or use allowances subject to the provisions of the applicable OMB cost principles and the requirements herein.

Procurement transactions must be conducted in a manner which provides, to the maximum extent practical, open and free competition consistent with the procurement standards published at 15 CFR Part 24 or in OMB Circular A-110, as applicable. When acquired personal property is no longer needed for RLF activities or is disposed of for upgrading purposes, the RLF should be compensated for its share of the disposition proceeds. Procedures should be established and followed to provide for the highest possible return on property disposition.

Employee Salaries & Fringe: Allowable employee salaries and fringe includes the compensation for personal services including, but not limited to salaries, wages and fringe benefits. Payrolls must be supportable by time and attendance or equivalent records for individual employees. Salaries, wages and fringe benefits of employees chargeable to more than one grant program or other cost objective must be supportable by appropriate time distribution records, or a cost allocation plan, and distributed equitably in reasonable proportion to the benefits received. Compensation for employee services may include only those services performed during the grant period.

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<sup>4</sup> A request for a grant amendment would allow the use of current period RLF Income for current purchases (up to \$5,000 per unit) for equipment, other capital assets, and repairs which materially increase the value or useful life of capital assets and which are essential for the operations and administration of the grantee's RLF program.

The salaries and expenses of the office of the Governor of a State or the chief executive of a political subdivisions thereof, are considered a cost of general government and are unallowable as an expense against RLF Income. The salary and expenses of an executive director of an EDA economic development district are allowable, provided such costs are allocated equitably relative to the benefits derived and the total costs charged against all grant programs does not exceed 100% of the cost item being allocated. Compensation of members of an RLF loan board is discussed under "RLF Loan Board Compensation" below.

Leasing Transactions: The accounting and financial reporting treatment for lease agreements depend on whether the lease is classified as a capital lease or an operating lease.

An operating lease is a rental agreement requiring periodic payments for the use of an asset during a given period of time. An operating lease does not transfer a material equity in the property leased. The rent payments under an operating lease are allowable to the extent that the lease rate is reasonable when compared with area market conditions.

A capital lease is a rental agreement where the lessee acquires a substantial portion of the rights to an asset. In substance, a capital lease represents the purchase of the asset. Financial Accounting Standards Board (FASB) Statement Number 13, *Accounting for Leases*, as amended, provides guidelines for capital lease transactions. The periodic payments under a capital lease are reimbursable up to the amount that would be allowed had the organization purchased the property on the date the lease agreement was executed. For example, reimbursable expenses could include depreciation or use allowances, maintenance, taxes and insurance, but excluding any unallowable costs.

For lease agreements between related parties, a determination must be made whether the related parties are required to prepare financial reports as a single reporting entity. If reporting as a single entity is required for financial reporting purposes, the assets of the organizations shall be combined, and any reimbursable expenses between the parties shall be computed based upon the cost of ownership. Specific financial statement disclosures pertaining to related parties are required by FASB 57, *Related Party Disclosures*.

Materials & Supplies: The costs of materials and supplies used during the accounting period for RLF-related activities are allowable expenses.

Outside Professional Services: The costs of RLF-related services necessary and appropriate to prudently administer and protect RLF assets are allowable. Examples of professional service providers include independent accountants, attorneys, appraisers and others who advise RLF operators and who are not officers or employees of the grantee organization or part of the grantee's department (if the grantee is a governmental entity). Professional service providers generally include those who provide loan packaging, underwriting, closing, monitoring, collections, recovery, sale, and/or protection of collateral services. Costs for professional services are eligible for reimbursement provided they are consistent with the purpose of the grant and allocated equitably based on the benefits derived. (See applicable OMB cost principles for additional information on professional services.)

RLF Loan Board Compensation: RLF loan board members, including advisory board members, who are not employees of the grant recipient, are not eligible for compensation from RLF Income except as may be provided for in the reimbursement of travel costs consistent with the grant recipient's travel policies or in accordance with Federal Travel Regulations (see "Travel" below). Since RLF loan board members usually serve as representatives of their profession or employer organizations, compensation for other than travel-related expenses is not normally allowed. However, if there are exceptional circumstances that warrant consideration of a waiver, EDA approval may be requested.

Training: The costs of training materials, textbooks, fees charged by educational institutions, and travel costs for part-time education of employees to improve their skills and performance in the management, administration and operation of an RLF are allowable. Extended or full-time training is unallowable except when specifically authorized by EDA in advance. Travel costs to attend meetings and professional conferences are allowable when the primary purpose of the meeting or conference is the dissemination of technical information relating to the grant program.

Travel: The costs for transportation, lodging, subsistence and related items incurred by employees who are on travel status for official business related to RLF activities are allowable. Typical travel expenses might include the costs associated with visiting or meeting potential borrowers, servicing and monitoring loan projects, and meeting with bankers, accountants, attorneys and others affiliated with existing or potential RLF borrowers. It may also include the travel costs associated with marketing the RLF program or hiring RLF program personnel.

Travel costs expensed to RLF Income must be applied consistent with the travel provisions established by the grant recipient in its regular operations and with the applicable OMB cost circular. Organizational travel provisions should be documented in a policy manual. In the absence of formal travel policies, the "Federal Travel Regulations" as published in the *Code of Federal Regulations* shall apply.

For additional information on allowable costs, refer to applicable OMB cost principles or contact the Office of Inspector General, U.S. Department of Commerce, or EDA's Regional or Headquarter's Office.

## **XV. SECURITIZATION**

RLF grant recipients may, **with EDA's prior written consent**, further the objectives of the RLF through the sale of loans or Securitization<sup>5</sup> of its loan portfolio. Auditors should determine whether Securitization has occurred, and if so, whether EDA consent was obtained.

## **XVI. ADMINISTRATIVE COST AND LOAN RECORDS RETENTION**

### **A. ADMINISTRATIVE COST RECORDS**

Records of administrative costs incurred for activities relating to the operation of the RLF shall be retained for three (3) years from the actual submission date of the last Semiannual or Annual Report which covers the period during which such costs were claimed, or for five (5) years from the date the costs were claimed, whichever is less. The retention period for records of equipment acquired in connection with the RLF shall be three (3) years from the date of disposition, replacement or transfer of the equipment.

### **B. LOAN RECORDS**

Loan files and related documents and records shall be retained over the life of the loan and for a three (3) year period from the date of final disposition of the loan. The date of final disposition of the loan is defined as the date of: (1) full payment of the principal, interest, fees, penalties and other fees or costs associated with the loan; or (2) final settlement or write-off of any unpaid amounts associated with the loan.

### **C. GENERAL**

If any litigation, claim, negotiation, audit or other action involving the RLF or its assets has commenced before the expiration of the three-year or five-year period, all administrative and program records pertaining to such matters shall be retained until completion of the action and the resolution of all issues which arise from it, or until the end of the regular three-year or five-year period, whichever is later.

The record retention periods described in this section are minimum periods and such prescription is not intended to limit any other record retention requirement of law or agreement. Any records retained for a period longer than so prescribed shall be available for inspection the same as records retained as prescribed. In any event, **EDA will not question administrative costs claimed more than three (3) years old. However, if fraud is an issue, records must be retained until the issue is resolved.**

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<sup>5</sup> Securitization is a financing technique of securing the investment of new capital with the stream of income generated by one or more (usually a large group of) existing loans. For EDA's purposes, the term intentionally encompasses a wide variety of techniques to access investor capital by securing those investments with the value of an existing RLF economic development loan portfolio. This deliberately broad definition covers a number of actual and potential schemes to access investor capital that appear to deviate from the more traditional definition and yet provide flexible alternatives to RLF operators for raising additional funds.

## ATTACHMENT 1

### CIRCULARS, REGULATIONS & OTHER DOCUMENTS FOR AUDITS OF EDA RLF GRANTS

The OMB circulars and Federal regulations relevant to RLF grant recipients are listed in the table below for the different types of RLF grant recipients, i.e., governments, nonprofits or universities. Since these and the other documents listed on page ii are updated periodically, users must be careful to utilize the most current version available.

CIRCULAR OR REGULATION	GOVERNMENT	NONPROFIT	UNIVERSITY
<b>Administrative Requirements</b>			
15 CFR Part 24	X		
OMB Circular A-110		X	X
<b>Cost Principles</b>			
OMB Circular A-21			X
OMB Circular A-87	X		
OMB Circular A-122		X	
<b>Audit Requirements</b>			
OMB Circular A-133	X	X	X

The regulations for EDA Section 209 (RLF) grants are found in Title 13 of the Code of Federal Regulations (CFR), Part 308. The Department of Commerce regulations implementing the OMB audit requirements are found in 15 CFR, Part 29.

Other duties and responsibilities of grant recipients are defined in the Special Terms and the Standard Terms and Conditions of each EDA RLF grant. Each RLF should have an RLF Plan which is included as part of the Special Terms and Conditions. The RLF Plan summarizes the RLF's lending strategy, the loan standards and the operational procedures under which an RLF will be administered.

In addition, all RLF grant recipients are required to follow policies and procedures as prescribed by EDA. The most recent are included in the prevailing EDA RLF Administrative Manual and in the RLF Standard Terms and Conditions. Both documents apply to all EDA RLF grants.

**Additional Guidance for State and Local Governmental Entities Audits**

American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide, *Audits of State and Local Governmental Units*, issued May 1, 1996.

AICPA Audit and Accounting Guide, *The Not-for-Profit Organizations*, issued June 1, 1996.

*Government Auditing Standards*, issued by the Comptroller General of the United States, 1994 revision (Yellow Book).

OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, issued June 30, 1997.

OMB *Provisional Compliance Supplement for Single Audits* (expected to be issued in late 1997).

**Additional Guidance for Non-Profit Entities Audits**

AICPA, Statement of Position 92-9, *Audits of Not-for-Profit Organizations Receiving Federal Awards*, issued December 1992. (Note: Because of significant changes to Government Auditing Standards and OMB Circular A-133, much of this is outdated. AICPA is developing a new SOP to supersede SOP 92-9).

AICPA Statement of Auditing Standards No. 74, *Compliance Auditing Applicable to Governmental Entities and Other Recipients of Governmental Financial Assistance*, issued February 1995.

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## **ATTACHMENT 2**

### **ECONOMIC DEVELOPMENT ADMINISTRATION SECTION 209 REVOLVING LOAN FUND GRANTS**

#### **(CFDA 11.307)**

#### **I. PROGRAM OBJECTIVES**

Revolving loan fund (RLF) grants for business development assistance are available under Section 209 of the Public Works and Economic Development Act of 1965 (PWEDA). These grants are administered by the Economic Development Administration (EDA) to help communities adjust to sudden and severe economic dislocations and long-term economic deterioration. RLF grants provide capital to establish loan pools which finance business activities and stimulate economic development in accordance with local development strategies. RLFs typically provide financing that is not otherwise available. Loan repayments plus interest and other income replenish RLF capital to provide a revolving resource for additional loans.

#### **II. PROGRAM PROCEDURES**

RLF grants are made to EDA designated economic development districts established under Title IV of PWEDA, Indian tribes, states, cities or other political subdivisions, consortia of political subdivisions, Community Development Corporations defined in 42 U.S.C. 9802, nonprofit organizations determined to be representative of a redevelopment area, and certain specified governments. Priority consideration for RLF funding is given to those proposals which have the greatest potential to benefit areas experiencing or threatened with substantial economic distress.

#### **III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES**

##### **A. Types of Services Allowed or Unallowed**

###### *Compliance Requirement*

Allowed Services: RLF grant and matching funds may be used only for purposes specified in the grant budget and grant agreement. Eligible uses normally include disbursements for RLF loans

and the audit costs of RLF activities. Unlike grant and matching funds, RLF Income<sup>1</sup> may be used for RLF loans as well as for eligible RLF administrative expenses (see Section C. Earmarking below for additional details).

### *Suggested Audit Procedure*

Review grant budget and grant agreement, and determine whether RLF funds were used for specified purposes.

## **B. Eligibility**

### *Compliance Requirement*

Eligibility: Eligibility for RLF assistance is based upon the following: (1) the activity financed being located in an eligible lending area (usually defined in the Special Terms and Conditions of the grant, as may be amended); and (2) the borrower being unable to obtain credit in the private capital market on terms and conditions which would permit the completion and/or successful operation of the project to be financed.

Ineligible Recipients: The RLF grant recipient cannot make a loan to itself, to related parties, or to entities that would violate the conflict of interest provisions of the grant agreement (see Section D.16. of the Standard Terms and Conditions).

### *Suggested Audit Procedure*

Review the Special Terms and Conditions and any amendments thereto, and scan the current addresses of selected RLF borrowers to determine whether borrowers are located within the eligible lending area.

On selected borrowers, test for borrower's inability to obtain private credit by verifying the **existence** of a loan write-up<sup>2</sup> in the grant recipient's files. If there is a potential violation, check the RLF Administrative Manual, Section IV.B.3., for exceptions; this Section also discusses the loan write-up. No other tests are necessary.

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<sup>1</sup> RLF Income includes the interest earned on loans, interest earned on accounts holding RLF funds not needed for immediate lending, loan fees received from borrowers, and other income generated from RLF activities.

<sup>2</sup> A loan write-up is a written record prepared by the RLF administrator which discusses, at a minimum, the need for providing RLF financing to a borrower. It may be supported by third party supplemental evidence as applicable and obtainable.

Review the conflict of interest provisions in the Standard Terms and Conditions, review any procedures that the grant recipient may have to avoid conflicts of interest, scan loan documentation, and determine whether RLF loans were made to ineligible recipients as defined above.

### **C. Matching, Level of Effort, and/or Earmarking Requirements**

#### Matching

##### *Compliance Requirements*

A matching share of nonfederal funds required is specified in the grant agreement. Matching funds must be loaned either before or proportionately with EDA grant funds. When loans are repaid, both the matching and the EDA funds must remain in the control of the grant recipient (or subrecipient) for the duration of the RLF.

##### *Suggested Audit Procedures*

Determine through the grant documents and recipient accounting records that required levels of matching were met.

Determine that the funds used for matching have been retained in the RLF.

#### Level of Effort (Capital Utilization)

##### *Compliance Requirements*

During the revolving phase<sup>3</sup> of an RLF grant, the grant recipient is expected to manage its RLF so at least 75 percent of the RLF's capital is in use. The size of the RLF may justify a variation from this standard percentage. Variations require EDA approval.

##### *Suggested Audit Procedures*

Determine that the percentage of outstanding loan dollars to total RLF capital complies with the prescribed usage level in the revolving phase. If the resultant percentage does not comply with the requirement, determine the duration or number of consecutive reporting periods of noncompliance. (See Section X., Capital Utilization Standard, of the EDA RLF Administrative

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<sup>3</sup> The revolving phase begins after all available grant and matching funds have been initially disbursed.

Manual for details, and note that the reporting periods end on September 30 and March 31 of each year.)

### Earmarking

#### *Compliance Requirements*

Pursuant to the prevailing EDA RLF Administrative Manual, RLF Income<sup>4</sup> earned in a period may be used for lending **or** for RLF administrative expenses of the same period only. Any RLF Income remaining at the end of a period must be permanently added to the RLF's capital base to be used for lending. Any exceptions require EDA approval.

(Note: Prior to March 15, 1993, RLF Income was not required to be added to the RLF capital base at the end of a period. The accounting period is selected by the grant recipient and ends on either its fiscal year end or the Federal fiscal year end. Repayments of loan principal may be used only for re-lending.)

#### *Suggested Audit Procedures*

Verify that any RLF Income earned within the period has been used for such period's RLF administrative expenses, for loans, or that any unexpended RLF Income earned in the period has been added to the RLF capital base.

## **D. Special Reporting Requirements**

#### *Compliance Requirements*

Grant recipients electing to use RLF Income to cover all or part of an RLF's administrative expense must annually complete an "RLF Income and Expense Statement." (If the grant recipient uses more than fifty percent or more than \$100,000 of a period's RLF Income for RLF administrative expenses, the statement is submitted to EDA within 90 days of the period ending date.)

#### *Suggested Audit Procedures*

Review the procedures for preparing the report (See Section VII. of EDA RLF Administrative Manual) and evaluate for adequacy.

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<sup>4</sup> Defined in Footnote 1, Page ii.

## **E. Special Tests and Provisions**

### *Compliance Requirements*

RLF grant recipients are expected to follow lending practices generally accepted as prudent for public lending programs.

### *Suggested Audit Procedures*

Review the grant recipient's RLF Plan for loan disbursement and collection procedures. Determine whether these procedures are being followed.

During the *Disbursement Phase*<sup>5</sup> of an RLF grant, a grant recipient must demonstrate there is sufficient RLF loan activity to draw grant funds within the approved period allotted. This usually is in accordance with the following schedule: 50% of grant and matching funds disbursed within 18 months of the grant award, 80% within two (2) years, and 100% within three (3) years. Any time extensions require EDA's approval. By law, grant funds remain available for disbursement by EDA only until September 30 of the fifth year after the fiscal year of the grant award.

## **F. Preservation of Government's Interest in Assets**

### *Compliance Requirements*

In instances where RLF grant recipients elect to *Securitize* their loan portfolios, EDA's prior written consent must be obtained and the value of the Federal Government's reversionary interest in assets retained.

### *Suggested Audit Procedures*

Review grant recipients records where *Securitization* may have occurred and determine whether grantee obtained EDA's *written* consent as required.

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<sup>5</sup> The Disbursement Phase is defined as the approved time period for drawing all EDA grant funds.